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SUBJECT: LATVIA'S 2007 BUDGET

¶1. Summary: In a relatively swift approval process, Latvia's parliament adopted its 2007 budget on December 19. The budget, featuring a 26 percent increase in expenditures (mostly growing public sector salaries and increased government investment), a projected 23 percent increase in revenues, and a budget deficit of 1.4 percent of GDP, is one of the most optimistic documents in recent years. However, in a stable international and domestic economic environment, it has a reasonably good chance at succeeding. In a political move, the budget lifts a unique exemption on income taxes for stipends paid to people carrying out work paid for by the Soros foundation. End summary.

¶2. On December 19, the Saeima gave final approval to the law on the state budget for 2007 and a package of changes in 26 related laws. National priorities for next year are healthcare, law enforcement, education, social welfare, absorption of the EU funds, and defense. The approval process this year was non-contentious and quick. The law is expected to take effect on January 1, provided the President signs it, which is fully expected.

¶3. The budget sets Latvia's budget expenses at LVL 4.4 billion (USD 8.2 billion), a 26 percent increase compared to 2006, and the projected revenue at LVL 4.2 billion (USD 7.8 billion), a 23 percent increase compared to 2006. Compared to state revenues and expenses just five years ago, Latvia's budget figures have more than doubled. The budget is based on a relatively optimistic 9 percent GDP growth projection and a realistic 5.9 percent inflation forecast.

¶4. Despite surplus budget revenues collected throughout 2006, the 2007 budget will run a deficit of 1.4 percent of GDP, largely because of the government's focus on salary increases and investment projects, as promised in the parliamentary election campaign. The GOL will increase the minimum monthly wage from LVL 90 (approximately USD 170) this year to LVL 120 (USD 225) in 2007. In addition, the GOL will raise salaries for law enforcement officers and several other groups in the public sector.

¶5. In addition to the dramatic increase in both revenue and expense projections and the increase in the minimum wage, several other noteworthy changes from this year's budget are increases in excise tax rates on fuel and cigarettes and an introduction of an electricity tax for industrial users. Additionally, the budget lifts an exemption from personal income taxes that has applied uniquely to stipends paid to grantees of the Soros Foundation that has existed since 2000. (Comment: Media affiliated with the greens and farmers party (ZZS) have been incredibly critical of Soros' operations in Latvia - mainly because Soros focuses heavily on allegations of corruption related to ZZS don and mayor of Ventspils Aivars Lembergs. We are told by NGO sources that ZZS pushed for this change in policy. That said, there also were objections that Soros received unique treatment and this now equalizes the treatment of all NGO's. End comment.)

¶6. Comment: The 2007 budget, which one Latvian journalist sarcastically called "the budget of hope," is perhaps the most

optimistic in Latvia's 15 years of restored independence. The 23 percent revenue increase has a reasonably good chance at success if international and domestic economic environments remain stable. However, if the current unprecedented growth -- fueled largely by domestic consumption and supported by large doses of wishful thinking -- suddenly turned sour, the budget deficit could skyrocket.

Antweiler